



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: **201125044**  
Release Date: 6/24/2011  
Date: March 30, 2011  
UIL Code: 501.33-00

Contact Person:  
Identification Number:  
Contact Number:  
Employer Identification Number:  
Form Required To Be Filed:  
Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: March 30, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

N = Name of Board Member  
O = Name of Board Member  
P = Name of Board Member  
Q = Name of Board Member  
R = Name of Board Member  
X = Date  
Y = Date  
Z = State

UIL:

501.03-00  
501.03-05  
501.03-08  
501.33-00

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issue

Does your primary activity of operating an art gallery for members preclude exemption under 501(c)(3)? Yes, for the reasons stated below.

Facts

You were incorporated on Y, in the state of Z. You submitted an application for recognition of exemption, Form 1023, on X. You submitted Articles of Incorporation and bylaws as attachments to Form 1023.

Letter 4036(CG) (11-2005)  
Catalog Number 47630W

Article 2 of your Articles of Incorporation states, "the corporation is a charitable or religious corporation".

Your purpose as stated in your bylaws is "to support, promote, and enhance the arts and crafts community by providing a retail outlet for area artists to display and sell original works of arts and crafts".

Article III of your bylaws states in part that artists shall be granted probationary membership upon nomination by the Jury Committee and approval of at least three quarters of the Board of Directors at a regular or special meeting of the Board of Directors. At the completion of a 12-month probationary period, the artist may be granted regular membership status by approval of at least three quarters of the Board of Directors at a regular or special meeting of the Board of Directors.

Article IV of your bylaws states in part that the term of office for each director shall be for life, or until resignation.

Article VII of your bylaws states in part that the President shall, subject to approval of the Board of Directors, appoint chairpersons for two standing committees, the Jury and Display Committees. The Chairpersons shall appoint committee members, subject to approval of the Board of Directors.

Article VII of your bylaws states in part that the Jury Committee shall have the responsibility to review works submitted by artists for display in the gallery and to recommend approval or rejection to the Board of Directors.

You currently have 5 directors, N, O, P, Q, and R. Each director is a founding member.

Your Explanatory Notes submitted with Form 1023, provides the following:

- A. You provide display space and sales gallery for nine member artists.
- B. Individual area artists may submit sample arts and crafts to be reviewed by the Jury Committee.
- C. The Board of Directors approves artists for membership based on recommendations of the Jury Committee.
- D. You conduct demonstrations of art weaving on a hand loom, demonstrations of art basketry and demonstrations of wood turning.
- E. You conduct and plan to conduct educational programs at the local elementary school that include, but are not limited to drawing leaves, drawing portraits, building clay birdhouses and constructing puzzles.
- F. Your president, N, has 18 years experience in art basketry. Duties of N are display and sales of art work.

- G. Your vice president, O, has 40 years experience in mixed media painting. Duties of O are display and sales of art work.
- H. Your director, P, is experienced in art and wildlife photography. Duties of P are display and sales of art work.
- I. Your treasurer, Q, is an experienced oil painter and clay artist. Duties of Q are display and sales of art work.
- J. Your secretary, R, is an experienced weaver, painter, and quilter. Duties of R are display and sales of art work.
- K. Each board member contributed \$2000 to start the organization.

You state your facility is only used to display member artists works for sale and for frequent artistic demonstrations. You also stated demonstrators have similar artistic works for sale in the gallery. Furthermore, you explain that all prices are set by each member artist. Sales price is determined using market factors and the artist's perceived value. Items available for sale in the gallery are chosen by member artists and only current members are allowed to display at the art gallery. An exception is an annual show for a guest artist.

You also state that all members pay a monthly membership fee of \$25. In addition to the monthly membership fee, you retain 20% of the sale price for each item sold. If a member has worked at least 10 hours in the gallery in any month, the commission is reduced to 10% for that month.

Approximately 10% of your activities were educational in nature in your first year. You plan to increase educational activities as the gallery develops and becomes more self-sustaining.

Financial data submitted with your Form 1023 lists revenue from board member contributions, membership fees and commissions from the sale of artwork. Expenses include occupancy expenses, bank fees, advertising expenses and printing expenses.

### Law

Section 501(c)(3) of the Internal Revenue Code of 1986 ("Code") provides for exemption from Federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized and operated exclusively for exempt purposes under Section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of private interest, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Revenue Ruling 66-178, 1966-1 C.B. 138, found that a nonprofit organization created to foster and develop the arts by sponsoring a public art exhibit at which the works of unknown but promising artists are selected by a panel of qualified judges for viewing and are gratuitously displayed is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Revenue Ruling 71-395, 1971-2 C.B. 228, found that a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting and selling their works does not qualify for exemption under section 501(c)(3) of the Code because the organization served the private purposes of its members, even though the exhibition and sale of painting may be an educational activity in other respects.

Revenue Ruling 76-152, 1976-1 CB 151, found that a nonprofit organization formed by art patrons to promote community understanding of modern art trends by selecting for exhibit, exhibiting, and selling art works of local artists, retaining a commission on sales less than customary commercial charges and not sufficient to cover the cost of operating the gallery does not qualify for exemption under section 501(c)(3) of the Code because the organization is serving the private interests of those artists whose works are displayed for sale.

In Goldsboro Art League, Inc., Petitioner v. Commissioner of Internal Revenue, 75 T.C. 337, 1980, the court found that the corporation was entitled to exemption from Federal taxation and entered a decision in its favor. The corporation contended that it was operated exclusively for exempt purposes, that the sale of artwork in its galleries was an incidental activity, but one which helped it pursue its exempt purposes, that it was not operated in furtherance of a substantial commercial purpose, and that the primary purpose of its sales and other activities was to further the public's appreciation of art and not to serve private interests. The Commissioner argued that since the corporation's activities were indistinguishable from activities required in operating a commercial art gallery for profit, the corporation was operated for a substantial commercial purpose and could not qualify for exemption under Section 501(c)(3) of the Code despite the presence of any number of truly exempt purposes. The court found that the purpose of the corporation's art gallery and art market was primarily to foster community awareness and appreciation of contemporary artists and to provide a constant flow of art for students to study art and painting techniques. The corporation's sales activities were incidental to its other activities and served the same overall objective of art education.

In Harding Hospital, Inc. v. United States, 505 F2d 1068 (1974), the court held that an organization seeking a ruling as to recognition of its exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

### Application of Law

You are not as described in section 501(c)(3) of the Code because you are not organized and operated exclusively for exempt purposes.

You are not as defined in section 1.501(c)(3)-1(d)(1)(ii) of the Regulations because you are operating for the private interest of your artist members whose art you sell. Providing a display and retail space for member artists, allowing each member artist to set the sales price and select the works for sale and receive a commission promotes the private interests of the artist members. Moreover, the education of the public is secondary to the sale of artwork.

You are not like the organization in Revenue Ruling 66-178, 1966-1 C.B. 138 because you are a membership organization consisting of artists who select and sell members' art work in a gallery operated by you. The artist member also earns a commission on work that is sold. Thus, you are operating for the private purposes of your members.

You are similar to the organization described in Revenue Ruling 71-395, 1971-2 C.B. 228 . because you were formed by a group of artists and are operating an art gallery opened to the general public, which displays and sells members' artwork. In addition, like this organization, a committee chosen by your board selects whose works will be offered for sale. Member artists also earn a commission on artwork that is sold. Consequently, like the organization in the revenue ruling, you are a vehicle for advancing members' careers and are promoting the sale of members' artwork. This serves the private purposes of your members, even though the exhibition of paintings may be an educational activity in other respects.

You are like the organization in Revenue Ruling 76-152, 1976-1 CB 151 because the artists whose works are displayed and sold are being directly benefited by your operations. Therefore, you have a substantial non-exempt purpose.

You are different from the organization in Goldsboro Art League, Inc., Petitioner v. Commissioner of Internal Revenue, 75 T.C. 337, 1980. Unlike this organization the sale of artwork is a substantial portion of your activities. In addition, all artists that display and sell art works are your members. Finally, your educational activities account for only 10% of your time.

#### Applicant's Position

You explain your purpose is to support, promote, and enhance the arts and crafts in the local area by providing a retail outlet for area artists to display and sell original works of arts and crafts, enhance art education programs in public schools, and cultivate interest in the arts for the general community. You stated that you operate in a small and economically disadvantaged community with few opportunities for practicing artists and fewer opportunities for those interested in arts and crafts.

You state that by providing a low cost venue, regional artists can gain valuable exposure. By providing exposure to arts and crafts and educational opportunities, budding artists can develop their talents. Furthermore, an additional retail outlet for artistic works in the area should encourage revitalization of the downtown area.

Finally, you listed three local art galleries in the area that are exempt under section 501(c)(3) of the Code.



### Service's Response to Applicant's Position

You failed to provide any additional information from which it can be concluded that your activities exclusively further or advance a purpose described in Section 501(c)(3). Although you provided the names of three organizations exempt under Section 501(c)(3) whose operations you believe are like yours, similar to the organization in Harding Hospital, Inc. v. United States, 505 F2d 1068 (1974), you have the burden of proving that you satisfy the requirements for tax exemption. You have failed to provide enough information to prove to us that you are not operating for the benefit of your members.

### Conclusion

Based on the information submitted, you are not operating exclusively for one or more purposes described in section 501(c)(3) of the Code. Even though some of your activities are educational, you are primarily operating to benefit your member artists and therefore, you are not described in section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.



Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service  
EO Determinations Quality Assurance  
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations